

**The Exempt Organizations Examination  
Support Section Accurately and Timely  
Processed Closed Examinations, but Controls  
Over Case Receipt Can Be Improved**

**February 2003**

**Reference Number: 2003-10-065**

**This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

February 28, 2003

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT  
ENTITIES DIVISION

*Gordon C. Milbourn*

FROM: Gordon C. Milbourn III  
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Exempt Organizations Examination  
Support Section Accurately and Timely Processed Closed  
Examinations, but Controls Over Case Receipt Can Be Improved  
(Audit # 200210021)

This report presents the results of our review of the Internal Revenue Service's (IRS) process to close examinations of exempt organizations. The overall objective of this review was to determine if the Exempt Organizations (EO) Examination Support Section (ESS) properly controlled and accurately processed EO cases after examinations were completed.

In summary, we determined that the ESS accurately and timely closed EO Examination cases. However, we identified a control weakness that increases the risk that completed examination cases may not be received by the ESS. At the time of our review, the closing unit's personnel could not be certain that completed examinations assigned to the unit were actually received. If the cases had not been received, any additional tax proposed after an examination may not have been assessed.

We recommended that the IRS establish written procedures and goals for case processing and case monitoring. In addition, the IRS should provide additional training on the use of management reports generated from the Exempt Organizations Inventory Control (EOIC) system. Furthermore, the IRS should complete its review of 269 cases identified from an EOIC system report to ensure that these cases were received and processed.

Management's Response: The Commissioner, Tax Exempt and Government Entities (TE/GE) Division, agreed with the recommendations presented in the report. Management will prepare written timeliness guidelines for case processing. Written guidelines have been established to ensure that ESS personnel receive completed

examination cases. In addition, ESS management has initiated a review of the 269 cases to determine if they were accounted for appropriately. Further, TE/GE Division management will cover the use of EOIC system management reports at a Fiscal Year 2003 training session for ESS personnel.

Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have any questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

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**Background**

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The mission of the Exempt Organizations (EO) Examination program is to identify and correct noncompliance. If, upon review, EO Examination personnel determine that an organization is not operating consistently with its tax-exempt purpose, the EO function may revoke the organization's tax exemption or impose taxes, depending on the type and severity of the violation. Once an organization loses its tax-exempt status, it will be subject to federal income tax.

Currently, there are more than 1.5 million exempt organizations that control assets of over \$2 trillion. EO Examination closed 5,342 tax returns during Fiscal Year (FY) 2001 and estimated that 6,100 tax returns would be closed during FY 2002.

Generally, after a revenue agent in an EO Examination field group completes an examination, the results are recorded on the Exempt Organization/Government Entities Examined Closing Record (Form 5599). This form, along with the case file, is sent to the EO's Examination Support Section (ESS) in Dallas, Texas, or Brooklyn, New York, for processing.

ESS personnel are responsible for ensuring all necessary documentation is included in the case file, inputting the examination results (as shown on the Form 5599) to the taxpayer's account on the IRS' computer system, and sending the closed case file to the appropriate IRS campus for filing. ESS personnel also input to the IRS' computer system any tax change proposed by the revenue agents and send a letter to the exempt organization notifying it of the official results of the examination. In addition, ESS closing units have a quality review process that checks the accuracy of sampled cases at the time of data input.

This audit was initiated in response to a request from the Director, EO, after additional tax resulting from the revocation of an organization's tax-exempt status was not timely assessed by the EO ESS function. The Director, EO, requested the Treasury Inspector General for Tax Administration's (TIGTA) assistance in evaluating the process used to close EO Examination cases and

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determining the risk that examination results may not be timely assessed during the closing process. The TIGTA also plans to conduct an audit assessing the adequacy and effectiveness of EO Examination statute controls in FY 2003.

During this review, we performed fieldwork in the ESS offices located in Dallas, Texas, and Brooklyn, New York. Our work was performed from April through September 2002 in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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**Cases Were Accurately and  
Timely Processed After  
Examination**

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Overall, the ESS accurately and timely processed EO cases after examination. Specifically, we determined that ESS personnel accurately input to the IRS' computer system the examination results proposed by the revenue agents. In addition, we determined that, overall, the ESS closing units timely processed examination cases that were assigned to the units for administrative closure.

Accurate and timely processing of cases after examination protects the government's interest for any examination assessments and ensures the correct tax account and program data are entered on the IRS' computer system. It also reduces taxpayer burden by eliminating unnecessary contact with taxpayers to resolve problems due to processing errors.

**Cases were accurately processed**

Our analysis indicated that ESS personnel accurately entered the examination results on the IRS' computer system for 246 (95 percent) of the 260 cases reviewed. In one case, ESS personnel did not input the correct tax adjustment on the IRS' computer system. Specifically, they did not enter an interest restricting code as requested by the EO Examination group. This resulted in an erroneous interest charge of \$5,207 to the tax account. The IRS removed the interest charge prior to any payment being made by the taxpayer, thus limiting any burden to the taxpayer. For the remaining 13 cases, insufficient

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information was available to determine the accuracy of case processing.<sup>1</sup>

**Overall, cases were timely closed**

According to the responsible ESS manager, the closing unit expects to complete its case closure responsibilities within 30 days of case assignment. However, the unit does not have written guidelines regarding time periods for closing a case. The General Accounting Office's (GAO) *Standards for Internal Control in the Federal Government* state that internal controls are to be clearly documented and should appear in management directives, administrative policies, or accounting manuals and may be in paper or electronic form.

Our detailed review of the 260 sampled cases indicated that 243 (93 percent) of the cases were closed within the ESS' 30-day goal. Of the 17 cases that were not closed within 30 days, 14 were closed within 60 days of being assigned to the ESS unit. The causes of the delays in case closings included end-of-year computer maintenance preventing input of case closure data from mid-December to early January, delays by EO Examination field groups in physically mailing the case files to the ESS, delays in the assignment of the cases to tax examiners after receipt by the ESS, and not having tax specialists to work complex cases involving restricted interest.

Although many of the above causes were outside of the ESS' control, establishment of written guidelines should help to ensure that the ESS continues to timely close cases.

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<sup>1</sup> In nine of these cases, neither the TIGTA nor IRS management could locate a Form 5599 to determine the proposed tax adjustment. In the remaining four cases, sufficient historical information was not maintained on the IRS' computer system to determine the amount of tax adjustment input by the IRS personnel.

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**Recommendation**

We recommend that Tax Exempt and Government Entities (TE/GE) Division management:

1. Establish written timeliness goals for ESS case processing.

Management's Response: TE/GE Division management will establish written timeliness goals for ESS case processing.

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**Controls Over the Receipt of  
Cases Can Be Improved**

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Although the ESS accurately and timely closed EO Examination cases, we identified a control weakness that increases the risk that completed examination cases may not be received by the ESS. As a result, any additional tax proposed after an examination may not be assessed. At the time of our review, ESS personnel could not be certain that completed examinations assigned to the unit were actually received. The Exempt Organizations Inventory Control (EOIC) system is the primary indicator to show that a case has been assigned to the ESS for closure. However, the ESS was not effectively using an available management information report from the EOIC system to ensure all cases assigned to them for closure by field groups were actually received.

The EOIC system is an inventory and management control system for EO Examination groups and is used to show where the case is currently assigned, as well as to transfer cases among the various EO Examination functions. The Internal Revenue Manual (IRM) states that the EOIC system is an important tool for effective management.

Furthermore, the IRM states that EO managers should ensure employees receive training for the EOIC system, and that system reports are analyzed to help assess group effectiveness. The GAO's *Standards for Internal Control in the Federal Government* state that the entire process of a transaction should be promptly and accurately recorded.

We conducted a "walk-through" of the closing unit to obtain an understanding of its operations. During this process, we requested a copy of the unit's *Cases Transferred But*

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*Unacknowledged* EOIC system report; however, the EOIC Clerk for the closing unit was not aware of the report and stated the report was not used within the unit. This EOIC system report lists each case recorded on the system as being sent but not acknowledged as being received. As such, it is important that ESS management regularly review this report and follow up on any cases not yet received to ensure they are not lost between the EO Examination groups and the ESS.

A staff member from another EO Examination unit printed a copy of the report, dated February 27, 2002. The report listed 269 cases as being sent to a closing unit but not acknowledged as being received in the unit. Because ESS management had not worked this report, we identified what appeared to be extremely lengthy delays in acknowledging receipt on the EOIC system of the completed examination cases. The following shows the number of days these 269 cases were unacknowledged as being received:

- In 33 cases (12 percent<sup>2</sup>), the cases were unacknowledged 400 or more days. One case was unacknowledged for 1,315 days.
- In 108 cases (41 percent), the cases were unacknowledged between 100 and 399 days.
- In 36 cases (13 percent), the cases were unacknowledged between 21 and 99 days.
- In 92 cases (34 percent), the cases were unacknowledged 20 or fewer days.

After we brought this issue to the attention of EO Examination management, they promptly took the following steps to address it:

- Conducted an EOIC system training class, primarily for Dallas ESS personnel, that included the use of various EOIC system reports.

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<sup>2</sup> All percentages in this list are subject to rounding.

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- Initiated a weekly review of the EOIC system's *Cases Transferred But Unacknowledged* report and began contacting functions to inquire about the location of a case that has not been received within 10 days of being assigned to the closing unit.
- Initiated a review of the 269 cases to determine if the closing unit received these cases. ESS personnel were still reviewing these cases at the end of our fieldwork.

We obtained an EOIC system extract and identified 80 cases sent to the closing unit during the period October 1, 2001, through January 31, 2002, that were still unacknowledged as being received as of March 15, 2002. Based upon our analysis, we determined that EOIC system case status information was not accurate on 58 cases because the EOIC system data indicated that the cases had not been received in the ESS, yet other IRS data showed that the ESS had processed and closed the cases.<sup>3</sup> For the remaining 22 cases, insufficient information was available on the IRS' computer system to determine if the cases were received and processed by the closing unit.<sup>4</sup> As a result, we could not determine if the examination results had been assessed on the IRS' computer system.

ESS management cannot be assured that examination cases were properly accounted for or timely processed because the EOIC system's *Transferred But Unacknowledged* report was not used. Furthermore, by not using this report, ESS management could not ensure that the applicable examination results were input to the IRS' computer system, or that the EOIC system was updated to accurately reflect the current status of the case. Additionally, delays in case

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<sup>3</sup> We compared the 80 cases to the 269 cases listed on the February 27, 2002, *Cases Transferred But Unacknowledged* report to determine if any cases were duplicated on both listings. Of the 58 cases where we determined that the EOIC database was incorrect, 39 were also included in these 269 cases.

<sup>4</sup> The IRS' computer system does not maintain information related to exempt organizations with gross receipts under a certain dollar amount.

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processing adversely affect taxpayer burden through delays in receiving refunds and an official notification about the final outcome of the examination.

**Recommendations**

To strengthen controls over the transfer of cases to the ESS, we recommend TE/GE Division management:

2. Establish written procedures for the weekly review of the *Cases Transferred But Unacknowledged* EOIC system report.

Management's Response: TE/GE Division management has established written procedures for a bi-weekly review of the *Cases Transferred But Unacknowledged* EOIC system report.

3. Complete review of the 269 cases shown on the February 27, 2002, *Cases Transferred But Unacknowledged* report to ensure these cases were received and appropriately processed.

Management's Response: ESS management has initiated a review of the 269 cases. As of January 7, 2003, ESS has accounted for all cases except for 17. The remaining 17 cases will be researched to determine if they were accounted for appropriately.

4. Provide EOIC system training to Brooklyn ESS personnel to ensure they are fully aware of how to use this system, including the availability of EOIC system management reports.

Management's Response: TE/GE Division management will cover the use of EOIC management reports at a FY 2003 training session for Dallas and Brooklyn ESS personnel.

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**Appendix I**

**Detailed Objective, Scope, and Methodology**

The overall objective of this review was to determine if the Exempt Organizations (EO) Examination Support Section (ESS) properly controlled and accurately processed EO cases after examinations were completed. Specifically, we:

- I. Determined the process used to control and accurately close EO Examination cases after the examination is completed.
  - A. Identified ESS locations that are responsible for administratively closing the EO Examination cases and the procedures followed for controlling and closing cases after examination.
  - B. Determined if a quality review process was in place to verify that cases were properly closed and processed by the closing units after examination.
- II. Determined if the EO closing units properly controlled and accurately processed cases after the examinations were completed.
  - A. Obtained an Exempt Organizations Inventory Control (EOIC) system data extract that identified all cases sent to the EO Examination closing units during the period October 1, 2001, to March 15, 2002.
    1. Randomly selected a statistical sample of 260 of the 2,743 cases sent to the closing units during this period. The sample was an attribute sample based upon a 90 percent confidence level, a precision rate of 5 percent, and an expected error rate not to exceed 40 percent.
    2. Reviewed the sampled cases and determined if the cases were properly controlled during the closing process and if the tax assessment information was timely and accurately input to the IRS' computer system.
  - B. Determined if cases sent to the closing units were controlled.
    1. Obtained an EOIC system data extract and reviewed all 80 EO Examination cases with an 'Assigned to Group' date between October 1, 2001, and January 31, 2002, (inclusive) that were sent to the EO closing units by EO Examination field groups but were not acknowledged as being received by the closing units on the inventory control system as of March 15, 2002.
      - a. Determined if the tax assessment was input to the IRS' computer system.

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**Appendix II**

**Major Contributors to This Report**

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

Nancy Nakamura, Director

Jeffrey M. Jones, Audit Manager

Margaret Anketell, Senior Auditor

Allen Brooks, Senior Auditor

Kenneth Forbes, Senior Auditor

Donald Martineau, Auditor

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**Appendix III**

**Report Distribution List**

Acting Commissioner N:C

Director, Exempt Organizations, Tax Exempt and Government Entities Division T:EO

Director, Communications and Liaison, Tax Exempt and Government Entities Division T:CL

Chief Counsel CC

National Taxpayer Advocate TA

Director, Legislative Affairs CL:LA

Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O

Office of Management Controls N:CFO:F:M

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**Appendix IV**

**Outcome Measures**

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Reliability of Information:

Actual – 58 cases for which case receipt information on the Exempt Organizations Inventory Control (EOIC) system was not accurate (see page 4).

Potential – 230 cases for which case receipt information on the EOIC system may not be accurate (see page 4).

Methodology Used to Measure the Reported Benefit:

**Actual** – We obtained an EOIC system extract and identified 80 cases sent to the closing unit during the period October 1, 2001, through January 31, 2002, that were still unacknowledged as being received as of March 15, 2002. Based upon our analysis, we determined that EOIC system case status information was not accurate on 58 cases because the EOIC system data indicated that the cases had not been received in the Examination Support Section (ESS), yet other Internal Revenue Service (IRS) data showed that the ESS had processed and closed the cases.

**Potential** – 1) We obtained the February 27, 2002, *Cases Transferred But Unacknowledged* report from the EOIC system. Our analysis of this report listed **269** cases as being sent to a closing unit but not acknowledged as being received in the unit. IRS management initiated a review of the 269 cases to determine if the closing unit received these cases. ESS personnel were still reviewing these cases at the end of our fieldwork.

2) We obtained an EOIC system extract and identified 80 cases sent to the closing unit during the period October 1, 2001, through January 31, 2002, that were still unacknowledged as being received as of March 15, 2002. We compared the 80 cases to the 269 cases listed on the February 27, 2002, *Cases Transferred But Unacknowledged* report to determine if any cases were duplicated on both listings. Of the 58 cases where we determined that the EOIC database was incorrect (see Actual above), **39** were also included in these 269 cases. As a result, these 39 cases were subtracted from the 269 cases (269 cases – 39 cases = 230 cases). For the remaining 22 of the 80 cases, insufficient information was available on the IRS' computer system to determine if the cases were received and processed by the closing unit. However, these 22 cases are also included in the 269 cases as Potential outcomes.

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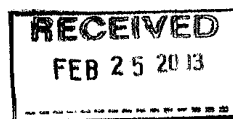
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**Appendix V**

**Management's Response to the Draft Report**




DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224



FEB 12 2003

**MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT**

**FROM:** Evelyn A. Petschek   
Commissioner, Tax Exempt and Government Entities

**SUBJECT:** Response to Draft Audit Report: The Exempt Organizations Examination Support Section Accurately and Timely Processed Closed Examinations, but Controls Over Case Receipt Can Be Improved (Audit #200210021)

Thank you for the opportunity to respond to your draft audit on determining whether Exempt Organizations (EO) Examination Support Section (ESS) properly controlled and accurately processed EO cases after examinations were completed.

I note with satisfaction that your report found that ESS accurately and timely closed EO examination cases. Accurate and timely processing of cases after examination serves to protect the government's interest for any examination assessments.

We take seriously that EO examination cases are properly accounted for and timely processed. We will provide additional training on the use of management reports generated from the Exempt Organizations Inventory Control (EOIC) system. We concur that measurable benefits on tax administration will be achieved with your recommendation to improve the reliability of case receipt information on the EOIC system for 58 identified cases and potentially improve the reliability of information for another 230 cases.

Our comments on the specific recommendations in the report are as follows:

**IDENTITY OF RECOMMENDATION 1**

The Commissioner, TE/GE Division, should establish written timeliness goals for ESS case processing.

**ASSESSMENT OF CAUSES**

According to ESS management, the closing unit expects to complete its case closure responsibilities within 30 days of case assignment. TIGTA found that the unit, however, does not have written guidelines regarding time periods for closing a case.

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**CORRECTIVE ACTIONS**

IRM 7.3.1.5.7 establishes processing timelines for large deficiency cases or over assessment cases (\$10,000 or over) of 22 calendar days. Although ESS has the informal goal of 30 days for other cases, we will prepare a written guideline incorporating the 30 day timeframe.

**IMPLEMENTATION DATE**

July 1, 2003

**RESPONSIBLE OFFICIALS**

Director, EO Examinations

**CORRECTIVE ACTION MONITORING PLAN**

EO Examination management will provide a written guideline incorporating the 30-day timeframe to the Director, EO Examination.

**IDENTITY OF RECOMMENDATION 2**

The Commissioner, TE/GE Division, should establish written procedures for the weekly review of Cases Transferred But Unacknowledged EOIC system report.

**ASSESSMENT OF CAUSES**

TIGTA found that ESS personnel were not certain that completed examinations assigned to the unit were actually received. The ESS was not effectively using an available management information report from the EOIC system to ensure all cases assigned to them for closure by field groups were actually received.

**CORRECTIVE ACTIONS**

Written procedures and guidelines have been established for a bi-weekly review and reporting of "Cases Transferred But Unacknowledged."

**IMPLEMENTATION DATE**

TE/GE has completed this recommendation.

**RESPONSIBLE OFFICIALS**

TE/GE has completed this recommendation.

**CORRECTIVE ACTION MONITORING PLAN**

TE/GE has completed this recommendation.

**IDENTITY OF RECOMMENDATION 3**

The Commissioner, TE/GE Division, should complete a review of the 269 cases shown on the February 27, 2002, "Cases Transferred But Unacknowledged " report to ensure that these cases were received and appropriately processed.

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**ASSESSMENT OF CAUSES**

TIGTA found that the EOIC system report entitled "Cases Transferred But Unacknowledged" dated February 27, 2002, listed 269 cases as being sent to a closing unit but not acknowledged as being received in the unit.

**CORRECTIVE ACTIONS**

ESS initiated a review of the 269 cases identified from the February 2002 list. As of January 7, 2003, all cases have been accounted for except for 17. We continue our research of the 17 cases.

**IMPLEMENTATION DATE**

April 1, 2003

**RESPONSIBLE OFFICIALS**

Director, EO Examinations

**CORRECTIVE ACTION MONITORING PLAN**

EO Examination management will provide a report regarding the status of the 17 cases to the Director, EO Examinations.

**IDENTITY OF RECOMMENDATION 4**

The Commissioner, TE/GE Division, should provide EOIC system training to Brooklyn ESS personnel to ensure they are fully aware of how to use this system, including the availability of EOIC system management reports.

**ASSESSMENT OF CAUSES**

TIGTA found that ESS personnel could not be certain that completed examinations assigned to the unit were actually received. The ESS was not effectively using an available management information report from the EOIC system to ensure all cases assigned to them for closure by field groups were actually received.

**CORRECTIVE ACTIONS**

A workshop covering the EOIC system and the use of management reports is planned for FY 2003 CPE for Dallas and Brooklyn ESS.

**IMPLEMENTATION DATE**

July 1, 2003

**RESPONSIBLE OFFICIALS**

Director EO Examinations

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**CORRECTIVE ACTION MONITORING PLAN**

This recommendation will be completed when the workshop is conducted for Dallas and Brooklyn ESS at the FY 2003 CPE.

If you have any questions concerning this response, please call Jim Templeman at (312) 566-3906.